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C O N F I D E N T I A L CANBERRA 000327

NOFORN

DEPARTMENT FOR EEB, EAP, EAP/ANP, EAP/EP

E.O. 12958: DECL: 03/31/2019
TAGS: ECON EFIN PREL CH AS
SUBJECT: AUSTRALIA BLOCKS CHINESE INVESTMENT ON SECURITY GROUNDS

REF: A. CANBERRA 298
¶B. CANBERRA 312

Classified By: Economic Counselor Edgard Kagan for reasons 1.4 (b/d).

Summary

¶1. (C) Treasurer Wayne Swan announced March 27 that the Australian Government would block the A$2.6 billion (USD 1.7 billion) bid by Chinese state-owned Minmetals Non-Ferrous Metals to purchase OZ Minerals, Australia's third-largest mining firm, on national security grounds. This is the first time a foreign investment proposal has been rejected for this reason. The decision came with the Treasurer yet to decide on PRC government-owned Chinalco's $19.5 billion bid for a larger holding in Rio Tinto as well as a bid by PRC-owned Hunan Valin for a stake in Fortescue Metals Group. The strong objections by the intelligence and defense community to Chinese ownership of a mine near the Woomera weapons testing range were the "end of the story," according to Swan's Chief of Staff, though the assessment by Government and independent analysts that OZ Minerals' mines are profitable and likely to keep operating without any layoffs regardless of the Government's decisions also played a part. Increasing controversy over Chinese investment comes at a time when Australia is pressing hard for FTA negotiations to include investment. End Summary.

MINMETALS TAKEOVER PROPOSAL FOR OZ MINERALS REJECTED
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¶2. (SBU) Treasurer Wayne Swan blocked a foreign investment proposal by Chinese state-owned Minmetals Corporation to acquire 100 per cent of OZ minerals on March 27. Swan's stated reason for the rejection is because Prominent Hill, a A$1.15 billion copper and gold mine near the Woomera weapons testing range, was included in the proposal. All major foreign investment proposals are examined under the Foreign Acquisitions and Takeovers Act, which gives the GOA (in the form of the Treasurer) a residual right to veto proposals. In this case, the Treasurer said the "Woomera Prohibited Area weapons testing range makes a unique and sensitive contribution to Australia's national defence" and rejected the proposal on national security grounds. The explicit reference to national security is an important detail, as the law gives Swan the power to reject deals "in the national interest." Prominent Hill was previously part-owned by another foreign firm - the US listed Newmont Mining. The

Treasurer last year included national security concerns as one of five criteria for judging investment by Chinese government-backed entities.

¶3. (C/NF) Chris Barrett, Treasurer Wayne Swan's Chief of Staff, told us March 30 that the decision was "pretty easy" because of the proximity of the Prominent Hill mine to the Woomera range (about 150 km, according to Barrett). Acknowledging that this is the first time that national security has been invoked to turn down part of a deal, he explained that intelligence and defense agencies had expressed concerned about the deal and that "we all know China would never permit a foreign company to do something QChina would never permit a foreign company to do something similar next to their equivalent of Woomera. Barrett stressed that Swan had been careful to only signal that sale of Prominent Hill would be denied and had not blocked the entire deal. The decision was made easier by separate assessments by the Department of Resources, Energy and Tourism as well as a consultant hired by the FIRB that OZ Minerals' underlying assets are quite profitable and very unlikely to shut down or even reduce production even if the company goes into receivership because it can't pay its debts. As a result, there are unlikely to be significant layoffs at the OZ facilities.

¶4. (SBU) The Minmetal's proposal could be subsequently approved without the Prominent Hill asset and Minmetals had reportedly already lodged an alternative offer for OZ Minerals (without Prominent Hill) that could save the debt-laden miner OZ Minerals from collapse. OZ Minerals owes its creditors A$1.3 billion and is close to being placed in bankruptcy. The company is continuing negotiations with its lenders, seeking an extension of the refinancing for certain of its banking facilities. Minmetals, while prohibited from buying the Prominent Hill mine (which only started production last month), appears willing to buy other assets owned by OZ Minerals, including the Century zinc and lead mine in Queensland and the Sepon gold and copper operation in Laos. BHP Billiton, which has been a vigorous opponent of the Chinalco bid for Rio Tinto (and possibly of the Minmetals proposal) is a potential suitor for the Prominent Hill asset and indeed previously owned the resource.

INVESTING IN THE AUSTRALIA-CHINA RELATIONSHIP

¶5. (SBU) China is Australia's largest two-way trading partner, but remains a minor investor, accounting for only one per cent of all investment assets in mining. Resources Minister Martin Ferguson recently said the GOA was "delighted" when foreign companies wanted to invest in Australia and develop its resources. "Australia is committed to open and transparent trade and investment frameworks to underpin global resources and energy markets and we will work with our trading and investment partners towards that goal." At the same time, there is a perceived disadvantage between Chinese state-owned firms backed by massive currency reserves and Australian firms trying to invest in China and often facing steep administrative barriers. This has led to a steady drumbeat of calls on the Rudd government to remind China that there should be progress on FTA negotiations, including better access for Australian investment.

¶6. (SBU) Treasurer Swan's decision was both unexpected and sudden, following quickly after a 90-day extension by the Foreign Investment Review Board of its review of the proposal grant on March 24. The Minmetals bid was considered the least controversial of the three bids then being considered, worth a combined A$30 billion. The other two are Hunan Valin's planned A$1.2 billion investment in Fortescue Metals Group and Chinalco's proposed A$19.5 billion investment in Rio Tinto. OZ Minerals, the world's second-biggest zinc miner, has been on the edge of bankruptcy, desperately needing a capital injection to clear $A1.3 billion (US$920 million) of debt before March 31. Analysts with Deutsche Bank, for example, considered none of OZ's assets of strategic value to Australia and judged that approval would

save jobs and keep OZ Minerals' assets open and working. Department of Resources, Energy and Tourism Secretary John Pierce told the Charge on March 19 that DRET had been, as usual, asked to prepare "baseline" briefings on what would happen to OZ Minerals if approval for the takeover was not granted. He indicated that while the company was wracked with debt, many of its actual assets were still valuable and Qwith debt, many of its actual assets were still valuable and would attract interest from other players even if the Minmetals bid was turned down.

INCREASING CONTROVERSY FOR CHINESE RESOURCES INVESTMENT
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¶7. (SBU) There has been an unusual amount of hostility towards recent Chinese bids for Australian resources companies - the value of which has fallen sharply because of the global economic crisis and the collapse of international commodity prices. There was a recent media protest over Prime Minister Rudd's "secret" (or unscheduled) meeting with Chinese Politburo Standing Committee member Li Changchun at his official residence before departing for the United States (ref A). National Party Senator Barnaby Joyce appeared in television commercials to oppose recent proposals: "If you hand the ownership of that asset to another country's government, not another corporation ... then disputes that you have in the future on things such as transfer pricing, the operation of the mine, go beyond the realm of just a corporate dispute. It will be a diplomatic issue with a very powerful and very important trading partner." Some observers attributed the timing to a desire by the GOA to be seen as tougher on Chinese investment, because of its increasing unpopularity in Australia - while others thought it was a signal to China about the need to accelerate FTA talks to include bilateral investment and especially easier access for Australian service firms into China. On March 17, Trade Minister Crean told a closed meeting of the Australian-China Business Council that investment between the countries needed to flow in both directions. Crean said a decision on Chinalco's proposed A$30 billion investment in Rio Tinto was not dependent on China removing barriers to foreign investment - but he noted that FTA negotiations had become "bogged down." He also said China should expand its investment into new greenfield projects rather than existing assets.

¶8. (SBU) One key issue is the low cost (compared to boom prices last year) of Australian resources companies has also triggered concern. Peter Costello, the longtime Treasurer under the Howard Government and now an opposition backbencher, has said the price paid (by Chinalco for part of Rio Tinto) would look exceptionally low when the global economy recovers and the Australian dollar appreciates." A second issue is the question of Chinese government control over Chinese resources companies. Notably, the Senate Economics Committee is currently inquiring into "the international experience of sovereign wealth funds and state-owned companies, their role in acquisitions of significant shareholdings of corporations, and the impact ... of such acquisitions." The Committee will report by June 17, the same time the FIRB must report on the Chinalco-Rio Tinto proposal to Mr. Swan. On this question, the Australian press widely reported that Chinalco's general manager, Xiao Yaqing, was appointed to the nation's cabinet - alleging this as evidence of the close links between Chinese state-owned companies and the Chinese government.

¶9. (C) Rio Tinto Government Relations Manager Mark O'Neill, a long-time Canberra insider who served as an advisor to former PM Paul Keating, told us March 31 that the Government's decision on Oz was driven by the fact that the decision will not cost jobs and that it allows the Government to "look tough" by saying no to China. Expressing skepticism about the national security grounds, he said that the Government is confident that China will not want to enter a debate on the question of whether or not it poses a security threat to Australia. He noted that the Government also looks good saying no to China in light of the questions about Defense

Minister Fitzgibbon's contacts with a Chinese friend, including failure to report two paid trips to China (ref b).

Comment

¶10. (SBU) Treasurer Swan's decision to veto Minmetals' acquisition of OZ Minerals (including Prominent Hill) reflects earlier concerns raised by the GOA over acquisition bids by government-owned companies, especially from China.
Qbids by government-owned companies, especially from China.
Policy statements issued by the government have suggested more Chinese investment in joint ventures or greenfield developments. The decision to veto on security grounds avoided any need to use other grounds such as competition policy (the Australian Consumer and Competition Commission had recently approved Chinalco's bid on this criteria) and may have sent a signal to the Chinese government to accelerate FTA talks on investment - possibly at the G20 Summit in London. In addition, the impact on OZ Minerals may be minor because of the attractiveness of the Prominent Hill asset for other buyers (such as BHP Billiton) and the strong possibility that the FIRB will approve of Minmetals' purchase of the rest of OZ Minerals. End Comment.

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